

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
DYNAMIC SPEAKER CORPORATION and)
TALONE PACKING COMPANY)

Appearances:

For Appellants: Robert P. Gowing
Peter Goldberg
Certified Public Accountants

For Respondent: Jean Ogrod
Counsel

O P I N I O N

These appeals are made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Dynamic Speaker Corporation against a proposed assessment of -additional franchise tax and penalty in the total amount of \$1,018 for the income year ended June 30, 1974, and from the action of the Franchise Tax Board on the protests of Talone Packing Company against a proposed assessment of additional franchise tax and penalty in the total amount of \$37,996 for the income year ended June 30, 1974, and against a proposed assessment of additional franchise tax in the amount of \$42,027 for the income year ended June 30, 1975.

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The issues presented for decision are: (1) whether appellants, Dynamic Speaker Corporation and Talone Packing Company, were engaged in a single unitary business with Verit Industries and Verit Industries' other subsidiaries; and (2) whether respondent properly imposed late filing penalties.

Verit Industries is a holding company headquartered in Beverly Hills, California. During the appeal years, Verit Industries and its subsidiaries were engaged in four principal areas of business. They were: (1) meat processing; (2) the design, production and distribution of high fidelity speaker units and related products; (3) the sale of mobile homes, travel trailers, related accessories and services; and (4) the formulation and distribution of agricultural chemicals. At some time during the fiscal years ended June 30, 1974, and June 30, 1975, the following corporations were wholly owned subsidiaries of Verit Industries.

1. Talone Packing Company

This company, a meat packing business, was founded in 1940 by Mario and Henry Talone. It operated a single slaughterhouse and beef processing plant in Escondido. Cattle were purchased in California. All products were sold within California, primarily by telephone, to independent retail meat dealers and supermarkets in southern California. The company made daily deliveries to its customers in a fleet of company-owned trucks. Talone Packing was purchased by Verit in October 1969.

2. Tex-Ag Co., Inc. (hereinafter "Tex-Ag")

This Delaware corporation engaged in formulation and wholesale distribution of agricultural chemicals in southern and central Texas. It operated out of a single facility in Mission, Texas. Verit acquired Tex-Ag in 1971 and sold it in February 1974,

3. Ted Walker Mobile Homes, Inc. (hereinafter "Walker")

This Arizona corporation engaged primarily in selling, renting, and servicing mobile homes, travel trailers, motor homes and related equipment from its facilities in Arizona. The company was also licensed in Arizona as an insurance agency and sold insurance relating to mobile homes. Walker maintained its own sales, rental, and service staff. Verit acquired this company in 1972 and sold it in August 1974. It was reacquired in 1976, when the purchaser failed to meet certain obligations.

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4. Wald Sound, Inc.

This California corporation manufactured and sold high fidelity speaker units. It also designed, manufactured and sold electronically activated psychedelic light systems, industrial baffles, speakers and mountings for use in intercom systems, and components for Master Antenna Distribution Systems (MATV) used to provide television to multiple users from a single main antenna. These operations took place at three facilities in California. Sales were made through the company's own sales staff. Speaker units and psychedelic light systems were sold primarily to distributors and large retail chains. Industrial sound components and MATV components were sold to electrical subcontractors.

5. Stradivari Sound, Inc.

This California corporation manufactured and assembled speaker cabinets. It merged with Wald Sound in June 1974.

6. Dynamic Speaker Corporation

This California corporation manufactured raw speaker units. Wald Sound owned 51 percent of this company's stock until February 28, 1974, when Wald acquired the remaining 49 percent. The company was not profitable and discontinued its operations during the 1975 appeal year.

Verit and its subsidiaries determined that during the appeal years, they were engaged in a single unitary business within and without California, and computed their income for those years by using combined reporting and apportionment of income procedures. Respondent audited the returns and determined that the diverse activities of Verit and its subsidiaries were not a single unitary business. Respondent further determined that because appellants' returns for income years ended June 30, 1974, were not filed until February 2, 1976, more than ten months after the extended due date of March 15, 1975, late filing penalties should be imposed under Revenue and Taxation Code section 25931.

We will first address the unitary business issue.

When a taxpayer derives income from sources both within and without California, its California

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franchise tax liability is measured by its net income derived from or attributable to sources within this state. (Rev. & Tax. Code, § 25101.) If a taxpayer is engaged in a single unitary business with affiliated corporations, its income attributable to California sources is determined by applying an apportionment formula to the total income derived from the combined unitary operations of the affiliated companies. (Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 163 (1947)].) The existence of a single unitary business is established by the existence of: (1) unity of ownership; (2) unity of operation as evidenced by centralized purchasing, advertising, accounting, and management divisions; and (3) unity of use in a centralized executive force and general system of operation. (Butler Bros. v. McColgan, 17 Cal.2d 664 [111 P.2d 334] (1941), affd., 315 U.S. 501 [86 L.Ed. 991] (1942).) The existence of a unitary business is also established by a showing that the operation of the business done within California is dependent upon or contributes to the operation of the business outside California. (Edison California Stores, Inc. v. McColgan, supra, 30 Cal.2d at 481.) Implicit in this latter test is an ownership requirement. The existence of a unitary business may be established if either the three unities test or the dependency or contribution test is met.

For income years beginning on or after January 1, 1980, combined reporting can be used by interdependent businesses operating solely within the state. (Rev. & Tax. Code, § 25101.15.) However, during the years on appeal, the combined unitary method could be used only by businesses conducted both within and without the state. (Handlery v. Franchise Tax Board, 26 Cal.App.3d 970 [103 Cal.Rptr. 465] (1972).) Therefore, in order to prevail, appellants must show that the out-of-state businesses, Ted Walker Mobile Homes, Inc., in Arizona, and Tex-Ag in Texas, were unitary with the operations of the parent and the parent's other subsidiaries. (Appeal of Arkla Industries, Inc., Cal. St. Bd. of Equal., Aug. 16, 1977.)

Unity of Ownership

During the appeal years, until Verit sold certain subsidiaries as noted in the facts, Verit owned directly or through a subsidiary 51 percent or more of the stock of the companies in question; therefore, the unity of ownership requirement is satisfied.

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Unity of Operation

Many of the factors indicative of unity of operation are not present here. There was no common facility, purchasing, advertising, employee training program, employee benefit program, intercompany personnel transfer, or insurance.. Each company had its own financial department and kept its own accounting records. Common research and development and exchange of know-how, if existent, were minimal. The only operational factor present to any degree is intercompany financing. Verit guaranteed, without charge, Walker's conditional sales contracts estimated to be approximately \$5 million, as well as the flooring and inventory contracts. The guarantees on the conditional sales contracts would have come into effect only if Walker could not repurchase repossessions from the lending institution for the amount of the unpaid principal balance of the note. Walker was able to repurchase all contracts on repossessed units. As part of the sale of Walker, Verit was released from its guarantees. Accordingly, Verit never had to perform under the guarantees. In addition, Walker, along with Wald Sound, guaranteed a bank loan for Verit Industries which was used to purchase Wald Sound.

Unity of Use

Appellants maintain that Verit and its subsidiaries were integrated by a strong central executive force. They point to overlapping officers and directors, regular financial reporting to Verit, and claim that Verit was involved in major policy decisions and day-to-day operations of its subsidiaries.

The record shows that Verit and its subsidiaries had a few common officers and directors. With respect to Tex-Ag, one of four officers was also a Verit officer, but there were no common directors. With respect to Walker, the other out-of-state business, one of three officers was also a Verit officer, and one of the two directors was also a Verit officer and director. Further, the record indicates that Walker and Tex-Ag were established businesses when they were acquired by Verit. After their acquisition, their prior owners continued to manage them. In an amended registration statement filed with the Securities and Exchange Commission during the year immediately preceding the appeal years, Verit gave the following description of the status of operating management:

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4. Status of Operating Management. The operations conducted by the Company are largely managed by persons who were owners of these businesses prior to their acquisition by the Company. Each such manager is a material factor in the operations of the business managed by him, and, in the aggregate, these managers are significant to the operations of the Company as a whole. ... The Company's corporate staff is small and as yet includes no persons who are experienced in operating the types of business presently conducted by the Company. (Resp. Br., Ex. C - 3 .)

The above statement indicates that management of the subsidiary operations was decentralized in that it remained the responsibility of the subsidiaries' prior owners. There is nothing in the record which establishes that Verit achieved strong central control over subsidiary operations in the two succeeding appeal years.

We must conclude that the unities of operation and use are insubstantial in this case. The only functions that had any degree of centralization or integration were the executive force and the intercompany guarantees. As we have already discussed, although there were some overlapping officers and directors of Verit and its subsidiaries, it appears that the out-of-state subsidiaries were largely managed by their former owners. With respect to the intercompany guarantees, some degree of common financial support is to be expected when any company conducts more than one business, and its presence alone does not make varied businesses unitary. (Appeal of Simco Incorporated, Cal. St. Bd. of Equal., Oct. 27, 1964.) There is nothing to indicate that these guarantees contributed to the operational integration of the companies. (See Appeal of the Amwalt Group, Inc., etc., Cal. St. Bd. of Equal., July 28, 1983.) We conclude that the three unities test has not been met.

The same factors which prevent appellants from meeting the three unities test also prevent them from meeting the contribution or dependency test. The record shows that there was little or no contribution and benefit from an integrated executive force, centralized service functions, or intercorporate product flow. There is nothing to demonstrate that these companies were engaged in a single integrated economic enterprise. (See Appeal of Hollywood Film Enterprises, Cal. St. Bd. of Equal., March 31, 1982.) We thus conclude that Tex-Ag and Walker were not unitary with Verit Industries and its subsidiaries.

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We now turn to the issue of whether respondent properly imposed late -filing penalties. Revenue and Taxation Code section 25931 imposes a late filing penalty when a taxpayer fails to file a return by the due date, or due date as extended by respondent. The penalty is mandatory, unless the failure to file is due to reasonable cause and not willful neglect.

At appellants' request, respondent extended appellants' filing date for the 1974 appeal year to March 15, 1975. Appellants did not file until February 5, 1976, almost eleven months after the extended due date. Appellants' letter to respondent dated March 3, 1980, indicates that appellants' late filing was due to "problems the corporations encountered in accumulating the information necessary to file a complete and accurate combined return by the normal filing date." This does not constitute reasonable cause. In Appeal of Telonic Altair, Inc., decided by this board on May 4, 1978, we stated:

It is well established that appellant has the burden of proving that the late filing of its tax return was due to reasonable cause and not due to willful neglect. (C. Fink Fischer, 50 T.C. 164 (1968); Appeal of Samuel R. and Eleanor H. Walker, Cal. St. Bd. of Equal., March 27, 1973) Both conditions must exist. (Rogers Hornsby, 26 B.T.A. 591 (1932); Charles E. Pearsall & Son, 29 B.T.A. 747 (1934).) On the record before us, there appears to have been no willful neglect on the part of appellant. To establish the existence of reasonable cause, however, the taxpayer must show that the failure to file occurred despite the exercise of ordinary business care and prudence. (Sanders v. Commissioner, 225 F.2d 629 (10th Cir. 1955), cert. den., 350 U.S. 967 [100 L.Ed. 839] (1956); Appeal of Loew's San Francisco Hotel Corp., Cal. St. Bd. of Equal., Sept. 17, 1973.)

The duty of preparing and filing a corporate return primarily rests upon the responsible executive officers of the corporation and such responsibility is not to be taken lightly. As a general rule, there is an absence of reasonable cause when clerical help or other corporate employees fail to file a timely return. (See Pioneer Automobile Service Co., 36 B.T.A. 213 (1937).) . . .

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Appellants have not demonstrated that their late filing was due to reasonable cause. Consequently, respondent's action must be sustained.

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O R D E R

Pursuant to the views expressed in the opinion of the board on file in these proceedings, and good cause appearing therefor,

IT IS-HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Dynamic Speaker Corporation against a proposed assessment of additional franchise tax and penalty in the total amount of \$1,018 for the income year ended June 30, 1974, and on the protests of Talone Packing Company against a proposed assessment of additional franchise tax and penalty in the total amount of \$37,996 for the income year ended June 30, 1974, and against a proposed assessment of additional franchise tax in the amount of \$42,027 for the income year ended June 30, 1975, be and the same is hereby sustained.

Done at Sacramento, California, this 27th day
of June , 1984, by the State Board of Equalization,
with Board Members Mr. Nevins, Mr. Dronenburg, Mr. Collis
and Mr. Bennett Present.

Richard Nevins, Chairman

Ernest J. Dronenburg, Jr. , Member

Conway H. Collis , Member

William II. Bennett, Member

_____, Member